

AIR NEW ZEALAND / QANTAS

CONFERENCE MEMORANDUM

- 1 Chapman Tripp (Grant David and Neil Anderson), LECG (Dr Graham Scott and Kieran Murray), Prof Jerry Hausman and Dr David Stone will appear at the conference on behalf of the following persons:

- 1.1 Gullivers Pacific Group;
- 1.2 Infratil Limited;
- 1.3 Major Accommodation Providers;
- 1.4 Kerry Prendergast, Mayor of Wellington;
- 1.5 Talley Fisheries; and
- 1.6 Wellington International Airport Limited.

This memorandum sets out broadly the topics to be covered. Of course, in addition, we reserve the right to respond to any matters covered by the Applicants in their submissions, and cross-submissions also raised at the conference itself.

Introductory remarks

- 2 Introductory remarks to include:
 - 2.1 Introduction of the parties represented and the persons representing those parties;
 - 2.2 Declaration of our interest in the proceedings and the perspective offered as suppliers to and customers of the Applicants;
 - 2.3 Outline of submissions to be made.

Concerns regarding the Government's involvement

- 3 The government has several interests at stake in Air New Zealand. The prospect of Qantas taking a shareholding interest in Air New Zealand raises issues, and many in cases conflicts, in respect of most of the government's interests.
- 4 The greatest potential for conflict lies in trade-offs between an objective for an economically efficient airline industry and the value of the government's shares.

- 5 It has been common in the past for the interests of a national airline to be confused with the interests of the citizens of the country in question.
- 6 The key to successful management of the various interests which the government now has in Air New Zealand is to be very focused on what each of those interests are and to balance them carefully and transparently in decision-making.

In this respect, the role and responsibility of the Commission is very clear. Its responsibility is to "promote competition in markets for the long-term benefit of consumers within New Zealand". In the long term, New Zealand consumers in general will benefit from continuous improvements in the allocation of resources, the quality of products and production processes, all of which are usually encouraged by the competitive process.

The impact of competition in the market

- 7 Illustrate the impact of increased competition in the market when the structure of the market changes using use passenger data through Wellington airport and the importance of these effects in downstream markets.

Economic arguments

- 8 An analysis of the economics of the Proposals to be presented, covering the following topics:
 - 8.1 Comment on competitive aspects of Air New Zealand's long haul routes and how these conditions impact on the Commission's assessment of the Proposals and the likely counterfactual;
 - 8.2 The effects on tourism and whether the Applicant's assumptions in relation to Qantas Holiday's impact on tourism are reasonable;
 - 8.3 The cost savings associated with the Proposals;
 - 8.4 Productive/dynamic efficiency losses;
 - 8.5 Engineering benefits claimed; and
 - 8.6 The Commission must reach a decision in circumstances where uncertainty will remain as to how events will unfold in the future. If Air New Zealand were to fail because of intense competition, consumers would benefit from the Commission declining the application as they would gain from competition in the interim. If Air New Zealand competes successfully, declining the application

benefits consumers by promoting competition in the relevant markets.

The counterfactual

- 9 The Applicants' "war of attrition" counterfactual is flawed because:
 - 9.1 It would be irrational for Air NZ to embark on a course that would lead to the airline's demise;
 - 9.2 It is likely that the entry of Virgin Blue would impact more on Qantas than on Air NZ;
 - 9.3 Competition on the Tasman from 5th freedom airlines has been overstated.

- 10 The Commission's counterfactual, under which Air NZ would continue to compete effectively and remain in a position to evaluate other commercial opportunities as and when they arise, is much more credible than that postulated by the Applicants because:
 - 10.1 Air NZ's financial position has greatly improved and been stabilised;
 - 10.2 Air NZ has reduced its costs, including through the successful introduction of its Express service on domestic routes, which will soon be extended to the Tasman;
 - 10.3 Air NZ's position on the Tasman will be further strengthened with the introduction of the new A320 aircraft;
 - 10.4 The retention of Freedom Air provides Air NZ the competitive advantage of a continuing low-cost operation;
 - 10.5 Air NZ has the ongoing advantage of being able to avoid the adverse impact of wars and tensions in the Middle East and neighbouring areas, and New Zealand is seen as a safe destination;
 - 10.6 Air NZ would be able to stay in the Star Alliance. United Airlines (UA) has exited NZ so that AirNZ has only Qantas to compete with for flights to US and UK from NZ.

Legal form of the Applications

- 11 Demonstrate that the Applications have been filed in a manner inconsistent with the scheme of the Commerce Act and in a manner that does not allow for the Commission or interested parties to test their respective merits appropriately.

Concerns regarding the Commission's process

12 The Applicants have been accorded special treatment in the following ways:

- 12.1 Being able to collapse both Applications into one and thereby circumventing the requirements of the Commerce Act (as we have already discussed);
- 12.2 Being granted timetable extensions outside the parameters contemplated by the Act and in a manner prejudicial to interested parties;
- 12.3 Being accorded various privileges with regard to access to confidential information given to counsel and experts.

Difficulties associated with conditions

13 Difficulties associated with conditions to be presented in the following ways:

- 13.1 Show that conditions are effectively "behavioural undertakings", expressly barred by statute for merger applications (US antitrust authorities will not allow these behavioural undertakings because (1) too difficult to monitor and enforce and (2) turns them into a regulatory agency);
- 13.2 Illustrate practical difficulties (especially regarding enforcement) associated with this particular set of conditions proposed; and
- 13.3 Demonstrate that imposition and extensive conditions in this case would represent a radical departure from the Commission's practice in authorisation proceedings and one for which no proper procedural foundation has been laid.